IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1977

No. 77-1253

LESLIE W. NIMMO, et al.,

Petitioners,

vs.

CHARLES S. GRAINGER, et al., on behalf of themselves and others,

Respondents.

PETITION FOR CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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The petitioners, Leslie W. Nimmo and Nimmo & Associates, Inc., respectfully pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Fifth Circuit entered in this action on February 18, 1977, in which rehearing en banc was vacated and rehearing denied on November 17, 1977.

I. PARTIES

Your petitioners are Leslie W. Nimmo, an Illinois resident and retired executive of Great States Life Insurance Company, an Illinois corporation ("Great States"), and Nimmo & Associates, Inc., an Illinois corporation, which, however, was dissolved prior to institution of this litigation. Your petitioners

together owned a controlling interest in Great States prior to its merger in 1968 into State Security Life Insurance Company, an Indiana corporation ("State Security").

Charles S. Grainger, Annie Marie Henson (successor to her husband Marvin Henson, Jr., who died December 31, 1971), Lawrence A. Wadsworth and James William Parsons are residents of Alabama and brought this suit in 1969 as plaintiffs in behalf of themselves and other purchasers of certain participating life insurance policies issued by Great States. State Security, whose capital, petitioners understand from one of plaintiffs' briefs, was declared impaired by the Insurance Commissioner of Indiana in spring of 1977, was also a defendant in this case below.

II. OPINIONS BELOW

The opinion of the Fifth Circuit dated February 18, 1977, holding that these life insurance policies could become "securities" under the Federal Securities Laws, is reported at 547 F.2d 303, and appears in the appendix hereto at pages A-6 et seq. Rehearing en banc, pursuant to petitioners' timely petition, was granted on May 25, 1977 (553 F.2d 1008), but, after briefs were submitted and oral argument had, was vacated and then rehearing denied by the panel on November 17, 1977 (A-14). Petition for reconsideration of vacation of the rehearing en banc was then denied by the writing judge in behalf of the en banc court on December 12, 1977 (A-16). The order and opinion of the U. S. District Court for the Northern District of Alabama, dated June 5, 1975, which held these life insurance policies not to be "securities" appears in the appendix hereto at pages A-18 et seq.

III. JURISDICTION

Federal jurisdiction is based on the Federal Securities Laws (see below); and jurisdiction of this Court is invoked by its authority to grant writs of certiorari under 28 U.S.C. 1254(1). Extensions of time for filing this petition were granted to March 10, 1978 (which is, however, within 90 days of the above December 12 order).

IV. QUESTIONS PRESENTED

The basic question presented for review is:

Can a life insurance policy containing a standard participating provision, or an endowment life insurance policy, become a "security" under the Federal Securities Laws?

A subsidiary question, invoking the supervisory jurisdiction of this Court, is whether a court of appeals is properly following the intent of Rule 56 of the Federal Rules of Civil Procedure pertaining to the granting of summary judgment when, even though depositions had been taken, affidavits filed and summary judgment rendered, the court of appeals expressly treats the case as if it were appealed from a bare motion to dismiss without any discovery and, after vacating a rehearing en banc, remands the case apparently for the taking of additional testimony.

V. STATUTES AND RULES INVOLVED

This case arises under the Federal Securities Laws, in particular the Securities Act of 1933, as amended ("the 1933 Act"), 15 U.S.C. 77a et seq., and the Securities Exchange Act of 1934, as amended ("the 1934 Act"), 15 U.S.C. 78a et seq. The principal provisions involved, which are set forth in the appendix, are: Sections 2(1) and 3(a) (8) of the 1933 Act; Sections 3(a) (10) and 10b of the 1934 Act and Rule 10b-5 thereunder; the McCarran-Ferguson Act; and a provision of the Illinois Insurance Code (Sec. 845) governing participating insurance policies. Of course, if these insurance policies are deemed to be "securities", then all of the registration and reporting provisions of the 1933 and 1934 Acts become applicable.

VI. STATEMENT OF THE CASE

This case squarely presents the question of whether participating endowment life insurance policies can become "securities" under the Federal Securities Laws. The policies were sold by Great States in 1962, and among the purchasers in Illinois and elsewhere were four purchasers in Alabama who brought

this class action, claiming $3 million in damages (plus attorneys fees and $10,000 punitive damages for each policyholder). The policy contains all of the standard provisions of an endowment insurance policy. Without burdening this Court on petition for certiorari with the entire instrument, the contract, which plaintiffs claim is a "security", begins as follows:

> "Great States Life Insurance Company of Quincy, Illinois, will pay the sum insured under the conditions hereof to the Insured on the Maturity Date if then living, provided all coupons hereon have been left with the company to accumulate at interest."

Both the sum insured and the amounts of the coupons are fixed dollar amounts as to which the policyholder bears no risk. The policy continues,

> "If the death of the Insured occurs before the Maturity Date, the Company will pay to the Beneficiary named, the Sum Insured upon receipt at its home office of due proof of the death of the Insured."

The policy then continues with various other provisions common to insurance contracts, such as a return premium rider payable in the event of death during the first ten years, settlement options, loan provisions, provisions for paid-up insurance and endowment privileges, and the non-forfeiture options required by state insurance laws and regulations.

At the bottom of page numbered 2 of the policy, is the participating provision (A-41-2) that has apparently created this litigation, which provision is a standard form used by stock insurance companies, and is set forth verbatim in Exhibit A to this petition, where it is compared with a sample participating provision contained in Huebner & Black, *Life Insurance* (8th Ed., 1972), 822. There is no special fund or account, the profits from which will determine the death benefit or cash values of the policy.

The Great States policies also had attached to them a series of coupons denominated "Guaranteed Premium Reduction Coupons", which could be used to reduce premiums payable in future years, to purchase additional paid-up insurance or ap-

plied to other options at the wishes of the policyholder. The coupons were in fixed dollar amounts.

There was attached to some of the policies sold, including those sold to the named plaintiffs in Alabama, an extract from the Illinois Insurance Code (Sec. 845) that required that 90% of the profits on participating policies (not the profits of the entire company) "inure to the benefit of the participating policyholders" (A-3). The extract from Illinois law attached to the policies sold plaintiffs had at the bottom of it the notation: "(All V.I.P. contracts issued by Great States Life Insurance Company in any state will be governed by this section insofar as the percent of profit is concerned)." Except for the above reference, the words "V.I.P. contract" appear nowhere in the insurance policies sold plaintiffs. The phrase "Variable Investment Plan" is, however, placed at the top of projection sheets given plaintiffs, in which the words "investor" and "investment" appear, showing the various cash and insurance benefits under the policies at selected years.

All insurance policies (except one-year term insurance) must have an investment element in order to provide for the payment of level premiums, and this investment element increases as one moves from ordinary life to endowment policies. The Great States policy was a 25-year term endowment and, thus, would have a high investment element. Plaintiffs' affidavits indicate the Great States policies sold them were sold as investments or investment policies, i.e. on the basis of the investment element of the endowment policies. The participating feature was also emphasized, and it was represented that after the first few years the dividends would be sufficient to pay the premiums and, in one case, a 40% profit. The District Court, after considering this evidence concluded, "At most, plaintiffs indicate that the salesmen treated the 'V.I.P.' insurance contract as if it were a 'security'," stating further in fn. 25, "Plaintiffs underscore the use of the word 'investment' in the contract and in the sales pitch. Although this term is subject to much abuse, it seems indisputable that insurance is usually a form of 'investment'. See *VALIC, supra,* 359 U.S. at 75 (Brennan, J., concurring).

Use of this term hardly warrants a finding that the contract here in issue was a 'security'." (A-46).

Great States initially adopted a dividend scale designed to pay out 90% of profits on the participating policies. This scale was adopted in early 1962, and a little over four years later in mid-1966 after experience showed that the profit projections on which the scale was based were not being realized, the company, in consultation with the Carl A. Tiffany & Company, Consulting Actuaries in Chicago, reduced the scale almost 50%. Great States, however, never made any profits on its ordinary (as opposed to group) life business — see Best's Insurance Reports—Life; and testimony in depositions taken by plaintiffs shows the reduced scale was adopted because Great States was paying dividends without having any profits.

Great States did not set up the separate accounting required by Illinois law nor has its successor State Security. However, "At present, State Security maintains a statutory reserve for the payment of benefits and obligations due under the V.I.P. policies." (A-27).

The relationship between premium and death benefit became an issue in this case as a result of the Fifth Circuit's initial decision, which set forth factors it considered relevant that would subject substantially all endowment policies to the Federal Securities Laws — see discussion under "Endowment Feature" at Part VII(1)(b), *infra*.

The District Court, in a comprehensive opinion, found that the life insurance policies here involved were not "securities" under the Federal Securities Laws (A-18 et seq.). On appeal, however, the panel of the Fifth Circuit held that the circumstances of their sale might cause such participating policies to become "securities" (A-6 et seq.). We ask this Court to note here that the District Court's decision was made on motion for summary judgment after the taking of eight depositions and submission of affidavits, whereas the Fifth Circuit declined to consider that status of the case and wrote its opinion erroneously as if the case had been appealed from grant of a motion to dismiss with barring of discovery.

Rehearing en banc was granted on May 25 of last year. At invitation of the Fifth Circuit, the SEC filed a brief and participated in the oral argument as amicus curiae. The SEC in general supported plaintiffs' position on the rehearing. In addition, another insurance company, National Insurance Company of America, filed an amicus curiae brief supporting defendants' position. NICOA was a defendant in a case argued at the same time and in which the *Grainger* opinion was incorporated by reference. ***Hilgeman v. National Insurance Company of America***, 547 F.2d 298 (5th Cir. 1977) (which, in addition, involved a number of complicated procedural issues).

After all the briefs had been submitted and oral argument held, the Fifth Circuit, however, vacated the rehearing, Judge Hill dissenting, and sent the case back to the initial panel, which then on November 17, 1977, denied rehearing (A-14). A petition for reconsideration of vacation of the rehearing en banc was denied on December 12 by the judge who wrote the initial panel opinion, issuing the order in behalf of the court (A-16). Stay of the court's mandate was granted on December 8 and a motion for extension of the stay was denied on January 25, 1978, each by the judge who wrote the opinion.[1]

Most of the named plaintiffs have also brought suits in the state courts, thus illustrating clearly that securities suits are not their only choice of legal action. Plaintiff Henson's case has even been appealed to the Alabama Supreme Court; and he has, thus far, lost on some counts and succeeded on others — see ***State Security Life Insurance Co. v. Henson***, 288 Ala. 497, 262 So. 2d 745 (1972). Plaintiffs Grainger and Wadsworth have similar suits pending in the Circuit Court of Jefferson County, Alabama — Nos. 21315 and 21316. At this point, it is appropriate to note that defendants recognize that plaintiffs in no way should be barred from their right to litigate any claims of fraud or breach of contract that they may feel they have. However, that should be done by individual or class suits in the

[1]Issuance of the mandate, however, does not destroy the power of this Court to review the lower court's judgment—see Stern & Gressman, *Supreme Court Practice* (4th Ed., 1969), Sec. 17.16 and cases therein cited.

proper state forum without trying to force these life insurance policies into the mold of a "security" under the Federal Securities Laws and, thus, greatly broadening the scope of those laws.

VII. REASONS FOR GRANTING THE WRIT

The panel of the Fifth Circuit has held (A-15) that in the sale of participating endowment insurance policies, "The totality of the circumstances surrounding their sale, including any oral representations made," can cause the policies to become "securities" under the Federal Securities Laws. By creating potential securities out of all such policies, the Fifth Circuit has greatly expanded the scope of those laws far beyond what defendants submit was the intent of Congress and has placed the Federal Courts in the business of policing, not a new field, but the historic field of life insurance policies. Such an expansion is contrary to the principles enunciated in *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975), *United Housing Foundation v. Forman*, 421 U.S. 837 (1975), and related cases recently decided by this Court, as discussed in Part (3) below, which have rejected expansion of implied remedies under Rule 10b-5. The decision of the Fifth Circuit is also in conflict with a 1969 decision of the Tenth Circuit (see Part (2) below) and is certainly an issue of national importance in interpretation and administration of the Federal Securities Laws since whether a company must register its participating or endowment policies or be subjected to 10b-5 class suits on them is clearly of great importance.

(1) The Holding of the Court of Appeals that a Life Insurance Policy with a Standard Participating Provision, or an Endowment Life Insurance Policy, can Become a "Security" is Erroneous, Conflicting in Principle with Decisions of this Court, and is an Issue of National Importance in Interpretation of the Federal Securities Laws.

At issue is a participating endowment life insurance policy issued by Great States. The District Court, after the taking of depositions and submission of affidavits in connection with motions for summary judgment, rendered a comprehensive opin-

ion, which was obviously heavily researched (A-18 et seq.), that these participating policies did not constitute "securities". Although the panel of the Fifth Circuit stated on rehearing that it had not yet held such policies to be securities, its "totality of circumstances" test, "including any oral representations made" (A-15), makes any policy where any of such circumstances exist a potential security subject to a 10b-5 class suit. Petitioners submit that this is contrary to principles enunciated by this and other courts, the legislative history of the 1933 Act and the views of learned commentators.

While the definitions of "security" in the 1933 and 1934 Acts (A-1) are broad, Section 3(a)(8) sets forth an exception to that definition for "any insurance or endowment policy", which, pursuant to court decisions and other authorities, is descriptive of the exclusion of such policies from coverage of the Federal Securities Laws. *Tcherepnin v. Knight*, 389 U.S. 332 at 342, n. 30 (1967), where as analyzed by this Court,

> "Congress specifically stated that 'insurance policies are not to be regarded as securities subject to the provisions of the Act,' H.R. Rep. No. 85, 73d Cong., 1st Sess., 15 (1933), and the exemption from registration for insurance policies was clearly supererogation."

To the same effect is 1 Loss, *Securities Regulation*, pp. 496-97 (2d Ed., 1961). Since the definition is virtually the same in the 1934 Act and the two acts are *in pari materia*, life insurance contracts are not included under either act.[2]

The panel of the Fifth Circuit seemed to be questioning, however, whether the Great States policy, even though having standard participating and endowment provisions, was an insurance policy since, in its denial of rehearing, it referred, for example, to endowment policies, placing those words in quotation marks. Reference briefly to comparable provisions and case and

[2]"The definition of a security in the 1934 Act is virtually identical and, for present purposes [whether instruments are "securities" within the purview of the 1933 Act and the 1934 Act], the coverage of the two Acts may be considered the same." *United Housing Foundation v. Forman, supra*, at 421 U.S. 847, n.12.

other authority shows, however, that the Great States policy described above under "Statement of the Case" is a standard form of participating endowment policy.

(a) **Participating Feature.** That the participating feature of the Great States policy is a standard participating provision should be clear from the comparison of it with the same provision of the sample participating life policy contained in Huebner & Black, *Life Insurance* (8th Ed., 1972), p. 822, attached as Exhibit A to this brief, where the Court will note the extreme similarity. Both provisions provide that the divisible surplus accruing on the policy shall be ascertained annually and shall be available under certain options, including payment to the policyholder in cash, application toward payment of renewal premiums, or purchases of paid-up additional insurance.

Such participating provisions are commonplace in the insurance industry and, in fact, are a part of all policies issued by mutual life insurance companies. The dividends are, in effect, a refund of premiums based upon the three factors that affect the divisible surplus of insurance companies: (1) Favorable mortality experience, (2) return on investment, and (3) savings in expenses. See the District Court opinion at A-42 and authorities therein cited.

Plaintiffs' contention, which is the genesis of this litigation, is that the participation provision caused these life insurance policies to become "securities". As stated in their main appellate brief (at p. 35), they contend the insurance exemption or exclusion should be limited to "non-participating policies of pure risk 'insurance' ", which would, thus, restrict it to term insurance.

That such a position is in conflict with principles enunciated by this Court is shown in *SEC v. Variable Annuity Life Insurance Co.*, 359 U.S. 65 (1959) ("VALIC"), where this Court rejected VALIC's argument that the SEC's position (to subject variable annuities to the securities laws) would make a participating policy a "security". As stated in the comprehensive concurring opinion of Mr. Justice Brennan, writing for himself and Mr. Justice Stewart:

"The respondents seek to equate this contract (the variable annuity) with a fixed-dollar 'participating' annuity sold by a mutual company, or one sold by a stock company on a participating basis. This contention is not persuasive. While investment experience in a 'participating' contract can redound to the benefit of the policyholder, the contracts are sold as fixed-dollar obligations. The 'dividends' are promoted as such. During the pay-in period, they might be thought of as a reduction of premium. They may very well represent favorable mortality risk experience, particularly where the company's investments are conservative." 359 U.S. at 89-90.

Thus this Court has clearly distinguished between policies with variable face amounts depending on the investment experience of a special fund, on the one hand, and the participating features of fixed dollar insurance policies, such as that involved in this case, on the other hand.

"Participating insurance accounted for $1,502 billion or 59% of all life insurance in force with U. S. companies at the end of 1976," *Life Insurance Fact Book '77*, American Council of Life Insurance, Washington, D. C.; and participating insurance was certainly well-known at the time of enactment of the Federal Securities Laws. Thus, it should be clear that a participating provision — and certainly a standard one as is involved here — should not convert a life insurance policy into a "security". To hold as did the Fifth Circuit in enunciating its "totality of circumstances" test, however, will potentially subject over one-half of the insurance in effect in the United States to the requirements of the Federal Securities Laws.[3]

[3]Plaintiffs and the panel of the Fifth Circuit placed great reliance on the provision of Section 845 of the Illinois Insurance Code (A-3) requiring that, in the case of companies selling both participating and non-participating policies, 90% of the profits on the participating policies shall inure to the benefit of the participating policyholders. However, as will be noted from the standard participating provisions set forth in Exhibit A, normally the amount that is apportioned to participating policyholders is dependent on discretion of the company's board of directors in allocating its divisible surplus. The Illinois provision, thus, is for the benefit of the policyholders in requiring the company to allocate 90% of the profits on the participating policies (not the profits of the entire

It should be noted that there is no special fund or account in the Great States policy similar to the so-called "flexible fund" involved in ***SEC v. United Benefit Life Insurance Co.***, 387 U.S. 202 (1967) ("United Benefit"). Thus, while the face amount of the Great States policy is fixed, the amounts of the annuities in *United Benefit* were, as stated on page 1 of the United Benefit policy:

> "Prior to the Maturity Date, the value of this policy is *not guaranteed* other than as specifically provided herein, but will depend upon the *investment experience* of Flexible Fund A." (Emphasis supplied.)

The Illinois Insurance Code (A-3) required companies issuing participating policies to "keep a separate accounting for each class of business", i.e., some form of cost accounting; but it did not require a separate fund or separate account as in *United Benefit* that might determine the face amount of the policy.[4] Consequently, because of the absence of any special fund or account, this case is completely distinguishable from both *VALIC* and *United Benefit* although plaintiffs would seek to have them treated the same.

(b) **Endowment Feature.** Section 3(a)(8) of the 1933 Act enumerates:

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company itself) to those policies; in other words, it is a restriction on the discretion of the board of directors. We submit the panel of the Fifth Circuit is surely in error in intimating that attaching such a provision to the policies might cause them to become "securities". To illustrate, as to those policies sold in Illinois, it would become part of the policy by operation of law whether attached to it or not. It would indeed be strange if a provision enacted pursuant to protective state regulation were somehow to cause policies subject to that state regulation also to become "securities" notwithstanding the McCarran-Ferguson Act, 15 U.S.C. 1012, reserving regulation of the business of insurance to the states. We submit, therefore, that such a construction would be completely contrary to the intent—and, in fact, express language—of Congress.

[4]The panel of the Fifth Circuit, thus, was in error when it stated at 547 F.2d 304-05 (A-7) that Illinois law:

> "[R]equired companies offering both participating and non-participating policies to keep separate accounts . . ."

"(8) Any insurance or endowment policy or annuity contract or optional annuity contract, issued by a corporation subject to the supervision of the insurance commissioner," etc.

Pursuant to the decisions of this Court, the legislative history of the 1933 Act and commentators such as Professor Loss, all referred to above in the discussion of Section 3(a)(8) at page 9, this provisions is descriptive of the exclusion of such policies from the coverage of "security" in both the 1933 and 1934 Acts. Endowment policies were certainly well-known and in existence at the time of enactment of the Federal Securities Law and, thus, were certainly excluded from their coverage. However, in its initial opinion on appeal, the panel of the Fifth Circuit suggested that the premium/death benefit ratio might be sufficient to convert a life insurance policy into a security.[5] Then, in the short opinion on denial of rehearing, the panel still indicated that the relationship between premium and death benefit "is a proper factor for consideration" in determining whether these life insurance policies might be "securities".

It is obvious that the premium/death benefit ratio is lowest in term insurance but, because of the guarantee of greater benefits, increases for ordinary life insurance and is higher for endowment insurance policies. The ratio will usually be higher for a term endowment than for one maturing, for example, at age 65 since, in the former, premiums will be paid for only 20 or 25 years while, in the latter, they will usually be paid for a longer period. Plaintiffs have, accordingly, referred to the Grainger policy in an effort to show the premium was too high.

[5]The panel for that purpose cited now rescinded Rule 3c-4 adopted by the SEC under the Investment Company Act of 1940 in administrative proceedings pertaining to variable life insurance contracts, i.e., life contracts with variable face amounts as contrasted with the fixed face amounts involved in the policies in the present case. The schedule set forth in Rule 3c-4, however, was based on ordinary life policies under which it was assumed premiums would be paid at least until age 65. Therefore, the so-called "industry norms", which the panel referred to at headnote 5 of its opinion and upon which it was judging whether an insurance policy might be a "security", could never be met by endowment policies since by their inherent nature they must have higher premiums.

That policy was a $10,000 25-year term endowment policy with a gross premium of approximately $400. However, although the panel of the Fifth Circuit seems to have felt that the premium was excessive, it is clear by comparison that it was in accord with premiums charged in the same year by substantial companies in the insurance industry.[6]

Does the Fifth Circuit's opinion, therefore, mean that all endowment policies — and certainly all term endowments — must now be registered under the 1933 Act? This would appear to be true since there is certainly an investment element in endowment policies (even though they have heretofore been considered excluded from the definition of "security"). In any event, it is certain that under the Fifth Circuit's decision, the doors of the courthouse have been opened for all disappointed purchasers of endowment life policies to bring a 10b-5 action on the ground that there was some misrepresentation in their sale, a result that would significantly expand coverage of the Federal Securities Laws and doubtless involve the Federal Courts through 10b-5 actions in regulation of the business of insurance in conflict with the McCarran-Ferguson Act, 15 U.S.C. 1012.[7]

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[6]The Grainger $10,000 policy, with a gross premium of approximately $400, was sold in 1962 to an insured aged 2 (although the Great States policy was not limited to juvenile insurance but was sold to applicants of all ages). In that same year 1962, the then largest mutual insurance company in the United States, Metropolitan Life, was quoting a premium of almost $500 for a 20-year endowment for a person the same age, which, adjusting to the 25-year period used by Great States, would approximate a premium of $400 (without any privilege of premium reduction through the use of coupons if so elected as was possible under the Great States policy). In 1962, Northwestern Mutual also had a term endowment similarly priced. See *Flitcraft Compend* (1962). *Flitcraft* is a standard copyrighted text, published annually and independently from any insurance company, that sets forth quotations for various life insurance policies issued by the leading life companies doing business in the United States.

[7]A further factor relied upon by the Fifth Circuit to cast these insurance policies into the mold of "securities" was the fact that these were coupon policies. The panel stated, "Attached coupons physically resemble coupons often attached to bonds." Apparently the theory is that because bonds have coupons and they are securities, a participating life insurance policy having attached "premium reduction coupons" might also be securities. We submit such a theory is stressing form over substance since the coupons

(c) "Method of Sale" will not Convert Participating or Endowment Policies into "Securities".

It would seem logically to follow that, if insurance policies are not securities — and the participating and endowment features set forth above are standard to policies historically considered not to be securities — then the method of sale of a policy could not cause it to become a "security". However, the panel of the Fifth Circuit has held to the contrary, stating that a court must consider "the totality of the circumstances surrounding their sale, including any oral representations made, in determining whether defendants were selling securities" (last sentence, first paragraph of denial of rehearing, A-15).

That such a position is in conflict with the authorities previously set forth becomes apparent when it is recognized that all forms of insurance (except one-year term insurance) must contain an investment element in order to permit level premiums. It was clear in 1933 that insurance policies did have significant investment elements; but despite their existence, insurance policies were excluded from coverage of the securities laws. This investment element will range from ordinary life to various types of endowment policies where it must of necessity be larger because of the greater fixed benefits contracted to be paid as is the case with the policy involved here. Thus, if an insurance agent fully describes the policy he is selling, he must describe its investment element. To hold otherwise would be to require

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are in fixed dollar amounts and can be used to reduce premiums or to purchase paid-up additional life insurance, which shows their clear relation to the life insurance policy to which they are attached. The District Court in analyzing them concluded (A-43):

> "Such coupon policies are not widely used, but they are a standard form of insurance. 1 Appleman, supra (*Insurance Law & Practice* (Rev. Ed., 1965)), Sec. 10. In effect the coupons are a guaranteed dividend, or rebate of premium. They are not premised upon a share in an investment pool and in no way represent a 'security'."

Turning to this Court's recent decision in *United Housing Foundation v. Forman, supra,* if naming the instrument construed there as "stock" did not create a "security", then surely including these coupons of fixed value on life insurance policies with fixed face amounts should not make them "securities".

a withholding of facts material to the purchaser of the policy; and, as this Court well knows, it is commonplace to show a prospective insured a table of anticipated cash values his policy will have.

As this Court is also well aware, billions of dollars of insurance are outstanding under policies of both mutual and stock companies that have participating and endowment features. Under the Fifth Circuit's decision, these policies, all of which must have an investment element, can, if an agent emphasizes the investment element of the policy, become "securities" but, if no mention is made of it, they apparently will not. Consequently, companies will be placed in an impossible position because of the *ad hoc* nature of the Court's decision since the same policy could be a "security" if sold in one manner and not if sold in another; and, thus, there will be no sure means under which a company can assure itself that its policies will not be subject to all of the Federal Securities Laws. As a result, the decision will subject a large segment of the American economy to large class actions and indeterminate liabilities for indeterminate amounts as criticized in *Blue Chip Stamps* and other decisions of this Court referred to in Part (3) below.[8]

Plaintiffs and the panel of the Fifth Circuit ground their holding that manner of sale can convert an insurance policy into a "security" on *SEC v. Joiner Leasing Corp.*, 320 U.S. 344 (1943) (which held sale of interests in oil and gas leases coupled with an agreement to drill an exploratory well constituted a security), and as it was later applied in cases involving chinchilla and similar enterprises, Scotch whiskey receipts or rare coin portfolios. However, we submit it is clearly erroneous to apply

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[8]By comparison, variable annuities and variable life insurance contracts have been held either by the courts or the SEC to constitute securities since they involve investment in a separate fund consisting of equities. In those cases, the company will know in advance that such a contract must be treated as a security. On the other hand, in the case of standard insurance provisions, such as participating or endowment features (which do not involve such investment funds), the insurance company will have no way of knowing in advance whether or not the policy will be subject to the securities laws.

it to participating or endowment insurance policies since, because of the inherent nature of insurance, such policies must have investment elements but are excluded from the securities laws under the express language of Congress, court decisions and commentators thereon cited above. So to apply *Joiner* would negate that exclusion.

(2) The Holding of the Fifth Circuit that a Life Insurance Policy with a Standard Participating Provision Can Become a Security is in Conflict with the Tenth Circuit.

The Tenth Circuit in *Olpin v. Ideal National Insurance Co.,* 419 F.2d 1250 (10th Cir. 1969), cert. den. 397 U.S. 1074 (1970), dealt with another form of participating provision and held that it did not cause the policy to become a "security" under the Federal Securities Laws. That participating feature was described as a "bonus fund endorsement" and was unlike the standard form involved in the present case. In addition, the sales literature used in that case (and quoted by the court at 419 F.2d 1253-4) referred to "investment" on repeated occasions; but the bonus endorsement there being construed was, nevertheless, held not to constitute a "security". Thus, the Tenth Circuit, in contrast to the Fifth Circuit here, has held that a participating insurance policy (even though not a standard one as is present here), coupled with investment language in its sale, would not constitute a "security" under the Federal Securities Laws.

(3) The Decision of the Fifth Circuit is Contrary to Recent Decisions of this Court Rejecting Expansion of Implied Remedies under the Federal Securities Laws.

This Court, in a line of recent comprehensive decisions, has rejected expanded interpretations of provisions of Rule 10b-5 such as are the result of the decision of the Fifth Circuit. Among these decisions are the following:

(i) *Blue Chip Stamps v. Manor Drug Stores, supra,* reversing the Ninth Circuit and holding that non-purchasers have no standing to bring actions under Rule 10b-5;

(ii) *United Housing Foundation v. Forman, supra,* reversing the Second Circuit and holding a document entitled "stock" was not a "security" when it was in fact a participation in a co-operative housing unit;

(iii) *Ernst & Ernst v. Hochfelder,* 425 U.S. 185 (1976), reversing the Seventh Circuit and holding that under Rule 10b-5, intent or scienter is needed for liability and not merely negligent conduct;

(iv) *Piper v. Chris-Craft Industries,* 51 L. Ed. 2d 124 (U.S., 1977), reversing the Second Circuit and refusing to imply liability under Section 14e of the 1934 Act and Rule 10b-6 for alleged fraudulent and manipulative conduct in connection with a tender offer; and

(v) *Santa Fe Industries v. Green,* 51 L. Ed. 2d 480 (U.S., 1977), reversing the Second Circuit and holding Rule 10b-5 inapplicable to the terms of a Delaware short-form merger.

The above cases show clearly the prevailing doctrine of this Court that the securities laws should not be expanded into new fields of implied remedies. Especially would that doctrine be applicable where the result would require court review of a whole new field of commerce, such as insurance policies with participating or endowment features, which Congress sought to exclude from coverage. That such a result would be contrary to the underlying theory of Rule 10b-5 is clearly shown in *Blue Chip Stamps* where this Court ruled that the *Birnbaum* rule, which limited plaintiffs in 10b-5 fraud actions to purchasers and sellers of securities, would not be relaxed so as to allow potential purchasers or sellers to maintain such actions. In so doing, the opinion of the Court discusses at length the dangers of determining securities law liability on an *ad hoc* basis and of opening up new areas for litigation under the Federal Securities Laws. Specifically, the Court stated:

> "Were we to agree with the Court of Appeals in this case, we would leave the Birnbaum rule open to endless case-by-case erosion depending on whether a particular group of plaintiffs was thought by the court in which the issue was

> being litigated to be sufficiently more discrete than the world of potential purchasers at large to justify an exception. *We do not believe that such a shifting and highly fact-oriented disposition of the issue of who may bring a damage claim for violation of Rule 10b-5 is a satisfactory basis for a rule of liability imposed on the conduct of business transactions.*" 421 U.S. at 755 (Emphasis supplied.)
>
> "The abolition of the Birnbaum rule would throw open to the trier of fact the many rather hazy issues of historical fact proof of which depended almost entirely on oral testimony. We in no way disparage the worth and frequent high value of oral testimony when we say that *dangers of its abuse appear to exist in this type of action to a particularly high degree.*" 421 U.S. at 743 (Emphasis supplied.)

All of the dangers articulated by this Court for not relaxing the *Birnbaum* rule are greatly magnified by the Fifth Circuit's decision in this case. Under that decision, there must necessarily be an "endless case-by-case" approach to determining which insurance policies are to be treated as subject to the Federal Securities Laws. Each case will necessarily depend on a "shifting and highly fact-oriented disposition" of the issue of "manner of sale". In addition, where a plaintiff can claim an alleged common question of law or fact — whether susceptible of ultimate proof or not — the "in terrorem" aspect of such litigation criticized in *Blue Chip Stamps, supra,* will also clearly be present, as shown by plaintiffs' present class suit for $3 million plus attorneys' fees and punitive damages brought against an insurance company and the former controlling stockholder of its predecessor.

There can be no policy — no matter how conventional — that could not, under the Fifth Circuit's decision in this case, be found to be a security if the plaintiff asserts that the investment element was overemphasized in its sale. Henceforth, no insurance company could safely forecast whether what was heretofore considered to be a conventional life insurance policy must be registered under the 1933 Act or will be made the basis for a 10b-5 class action under the 1934 Act. It will be impossible for counsel to advise clients whether a given policy should be regis-

tered since, depending on the "totality of circumstances" test, it always can potentially be a "security". As a result, the panel's decision will place heavy burdens and risks on the insurance industry — not to mention the burdens on the courts in regulating the insurance business through handling such litigation.

(4) This Court has Recently Accepted Certiorari in Another Case Involving Expansion of Implied Remedies under Rule 10b-5.

This Court has recently granted certiorari to the Seventh Circuit to review its decision in *Daniel v. International Brotherhood of Teamsters*, etc., 261 F.2d 1223 (7th Cir. 1977), in which that circuit held that interests in non-contributory pension plans under collective bargaining agreements were securities for purposes of Rule 10b-5. 46 U.S.L.W. 3512 (U.S., Feb. 21, 1978).

Although the statutory context of that case is different,[9] if this Court reverses that decision of the Seventh Circuit and, hence, rejects such a broad expansion of coverage of Rule 10b-5, then it would be only consistent to reject the similar broad expansion under the decision of the Fifth Circuit in this case that will create potential "securities" out of all participating or endowment life insurance policies.

(5) The Court of Appeals, by Erroneously Treating the Case as if it were Appealed from a Motion to Dismiss Without any Discovery, Failed to Give Effect to the Intent of Rule 56, F.R.C.P., Providing for Granting of Summary Judgment.

We recognize that plaintiffs in opposition to this petition may urge that the Fifth Circuit remanded the case and, thus, that it is not ripe for decision by this Court. However, that remand-

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[9]The Seventh Circuit expressly ruled that the pension interests in *Daniel* were exempt from the registration provisions of the 1933 Act and the reporting provisions of the 1934 Act. In the instant case, however, insurance and endowment policies, under the legislative history, decisions of this Court and views of learned commentators referred to above under Part (1), should be excluded from being "securities" under all the Federal Securities Laws. As a consequence, regardless of the deposition of *Daniel*, the statutory context shows that *Grainger* should be reversed.

ment is based on a completely mistaken view of the procedural posture of the case.

The District Court, by its order of June 20, 1972 (A-17), elected "to treat the motion to dismiss filed in behalf of each defendant as a motion for summary judgment" and to allow the parties to submit any affidavits or other documentary evidence which they may deem relevant to determination of whether the insurance contracts involved constituted "securities". There had been no order blocking discovery as erroneously indicated in the panel decision at 547 F.2d 305 (headnote 1), and the District Court had before it extensive depositions, most of which were taken by plaintiffs. Plaintiffs also filed affidavits as to the facts upon which they were relying and, consequently, the District Court did consider that evidence, as appears clear from the fact that it stated in its opinion the nature of the case "warrants the consideration of more evidence than is usually appropriate to motions to dismiss" (A-23). Nevertheless, plaintiffs and the Fifth Circuit seem to wish to remand this case for further testimony and other proceedings.

The Advisory Committee Notes on Rule 56 characterize summary judgment as a "salutary device" and as "in the interest of more expeditious litigation". Petitioners submit that, considering the correct procedural posture of the case, it was highly inappropriate for the Fifth Circuit to disregard that procedure and to remand the case as if it were decided on a motion to dismiss and as if there had been an order barring discovery. Such a procedure is contrary to the basic principle of use of Rule 56 to expedite litigation and can only serve to burden the dockets of the lower courts by requiring additional time and unnecessary proceedings.

Such a procedure also appears contrary to the Fifth Circuit's own decision in *Surkin v. Charteris*, 197 F.2d 77 (1952), holding, "The opposing party (opposing the motion for summary judgment) must sufficiently disclose what the evidence would be to show that there is a genuine issue of fact to be tried." Plaintiffs' last depositions were noticed in 1970; and if they had

some other evidence that they thought would somehow convert these insurance policies into securities, then it should not be their privilege after all these lengthy proceedings now to claim that there is a material dispute as to facts (as contrasted with interpretations to be placed on them) not disclosed before the lower court. In this connection, it is noted that the foregoing decisions in *Blue Chip Stamps, United Housing* and *Santa Fe Industries* by this Court and *Ideal National* by the Tenth Circuit were all decided on motions to dismiss, whereas this case has been decided against the background of more extensive discovery proceedings prior to disposition on motion for summary judgment.

Further proceedings, in disregard of the posture of the proceedings in the lower court, will only continue to give this $3 million class suit the "in terrorem" effect criticized by this Court in *Blue Chip Stamps, supra.*[10] That the failure to implement Rule 56 is a matter of concern to effective judicial administration, especially in federal securities litigation, was expressed in that case where this Court stated:

> ". . . In the field of federal securities laws governing disclosure of information, even a complaint which by objective standards may have very little chance of success at trial has a settlement value to the plaintiff out of any proportion to its prospect of success at trial *so long as he may prevent the suit from being resolved against him by dismissal or summary judgment.*" 421 U.S. at 740. [Emphasis supplied.]

The foregoing shows not only that this litigation is in an appropriate procedural stage to be brought before this Court but also that the appellate procedure employed makes it desirable for exercise of this Court's supervisory jurisdiction.

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[10]This is particularly true since the Fifth Circuit granted a rehearing en banc but then, after briefs had been submitted and even after oral argument had been held, vacated the rehearing en banc, sending the case back to the original panel which then remanded it to the lower court (a procedure that makes the expense of such litigation virtually prohibitive to an individual who is made a defendant).

VIII. CONCLUSION

For the foregoing reasons, petitioners respectfully urge that, because of conflict with principles enunciated by this Court and other circuit courts and the national importance in interpretation of the Federal Securities Laws, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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COMPARISON OF PARTICIPATING PROVISIONS

Great States Policy

"The proportion of the divisible surplus accruing upon this policy shall be ascertained annually by the Company. Beginning at the end of the second policy year, and on each anniversary thereafter, such surplus as shall have been apportioned by the Company to this policy shall be available under any one of the following options, upon written request by the person having control of this policy: (1) applied toward payment of renewal premiums; or (2) applied to purchase participating paid-up additional insurance payable under the same terms and conditions as this policy; or (3) left with the Company to accumulate at interest at a rate of not less than 2½% per annum compounded annually; or (4) paid in cash. Outstanding dividend accumulations may be withdrawn in cash or shall be payable at the maturity of this policy to the person or persons entitled to its proceeds. If no option is selected, such divisible surplus will be paid in cash."

Huebner & Black Sample Policy

Upon payment of the premium for the full second policy year, and thereafter at the end of the second and each later policy year, this Policy, while in force other than as Extended Insurance, will be credited with such share of the divisible surplus, if any, as may be apportioned to it by the Company as a dividend. At the option of the payee, each dividend shall be applied under one of the following:

(1) CASH – Paid in cash.

(2) ACCUMULATION – Left with the Company, subject to withdrawal, to accumulate at interest, credited annually, at the rate declared by the Company but not less than 2¾%, but with no interest allowed for any fraction of a policy year.

(3) PREMIUM PAYMENT – Applied on a premium due on this Policy.

(4) PAID-UP ADDITION – Converted into a participating paid-up addition to the sum insured under this Policy. Any such additions outstanding may at any time be surrendered to the Company for cash in an amount equal to their reserve.

Unless the Company is otherwise directed in writing within 31 days after a dividend becomes payable, that dividend will purchase a paid-up addition under option (4). (As an alternative, some companies provide for automatic payment in cash if there is no other direction.)

(For ease of comparison, the main comparable language is underlined.)

EXHIBIT A